

VERIZON MASSACHUSETTS

DIRECT TESTIMONY OF LOUIS D. MINION

FEBRUARY 12, 2001

Q. Please state your name and position with Verizon.

A. My name is Louis D. Minion, and my position is Manager-Service Costs in the Verizon Finance department. In that position, I am responsible for economic analyses and cost studies for the Company's products and services as well as providing regulatory support.

Q. Please describe your education and professional background.

A. I attended the University of Chicago for two years before transferring to Columbia University, where I received a Bachelor of Science Degree in Applied Mathematics in 1982. I received a Master of Science Degree in Mechanical Engineering from the New Jersey Institute of Technology in 1989.

I began my career with New York Telephone Company in June 1982 as an Outside Plant Engineer, as which I was primarily responsible for trouble report rate analysis, outside plant mechanization projects, budgets, estimate case preparation and work orders. In September 1986, I was promoted to the position of Staff Director in the Service Costs organization. In this position, I worked on special studies related to outside plant facilities, before embarking on a special eleven-month internship program at Bellcore in 1987. From August 1988 through December 1994, I worked on customer-specific pricing requests for large business users. In January 1995, I assumed my current responsibilities in Service Costs. I participated in the initial development of NYNEX's Total Element Long-Run Incremental Cost ("TELRIC") methodology and its avoided cost methodology for resold services.

I have testified before this Department in the *Consolidated Arbitrations* (Dockets 96-73/74/75, 96-80/81, 96-83 and 96-94). I have also testified before the following state regulatory agencies on various cost issues: New York Public Service Commission, Maine Public Utilities Commission, New Hampshire Public Utilities Commission, Vermont Public Service Board, Rhode Island Public Utilities Commission, Pennsylvania Public Utilities Commission, and Maryland Public Service Commission.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the methodology that Verizon Massachusetts, Inc. ("Verizon MA") has used to determine the appropriate discounts that apply when Verizon MA's retail telecommunications services are resold by carriers pursuant to section 251(c)(4) of the Telecommunications Act of 1996. Attached to my testimony is an avoided cost study with supporting workpapers that identifies the costs the Company avoids in making its retail telecommunications services available for resale in Massachusetts. There are two scenarios presented. One is where the reseller continues to use Verizon MA Operator Services and Directory Assistance ("OS/DA"). The other is where the reseller uses its own platform (or the platform of a third party other than Verizon MA) to provide OS/DA functions.

Q. Are you familiar with the cost study that the Company presented in the *Consolidated Arbitrations* and which was the subject of the Department's Phase II Order in that proceeding?

A. Yes. The study that Verizon MA presented in that docket was designed to comply with the methodology prescribed by the FCC in its August 18, 1996, *Local Competition Order*, and codified in 47 CFR § 51.607 and 609. The FCC's methodology calculated wholesale rates based on the costs that were potentially avoidable by Verizon MA under a hypothetical construct in which Verizon MA completely exited its retail business and became a 100 percent wholesale company in Massachusetts.

Q. Did you use the same methodology in the study attached to your testimony?

A. No. On advice of counsel, I am informed that the FCC's methodology for determining resale discounts was invalidated by the Eighth Circuit Court of Appeals in its decision in *Iowa Utilities Board v. FCC* issued in July, 2000. A copy of that decision is attached to my testimony. Verizon MA's study is based on the Eighth Circuit Court's ruling concerning the type of analysis called for by the Telecommunications Act. Specifically, the Court ruled that the Act provided a clear standard in § 251(d)(3) for determining the wholesale discounts. The Court stated:

The language of the statute is clear. Wholesale rates shall exclude "costs that will be avoided by the local exchange carrier." ... The plain meaning of the statute is that costs that are actually avoided, not those that could be or might be avoided, should be excluded from the wholesale rates.

The Court also addressed the FCC's hypothetical construct of a 100 percent wholesale company. The Court stated:

The statute recognizes that the ILEC will itself remain a retailer of telephone service with its own continuing costs of providing that retail telephone service. ... Under the statute as it is written, it is only those continuing costs of providing retail telephone service which

will be avoided by selling to the competitor the services it requests which are to be excluded.

Consistent with the Court's ruling, the Verizon MA study is founded on detailed analyses of its actual expenses and identifies specific functions/expenses that it avoids in making its Massachusetts retail telecommunications services available for resale by telecommunications carriers. The avoided cost as a percentage of total revenues is applied as a discount to each retail rate subject to resale to determine the rate for resold services.

Q. Please describe the methodology that you used to determine Verizon MA's actual avoided cost which was then used to calculate the resale discount rate.

A. I used a functional approach to determine the avoided cost included in the calculation of the resale discount rate. The study begins with Verizon MA's 1999 functional accounting data that is the underlying detail supporting the ARMIS reports filed with the FCC. I used 1999 data because it is the most current annual period for which complete accounting information is available. Using this detailed function code data (Tab 12 provides a short descriptor of each of the function codes) as the starting point, the study identifies avoided costs using the following steps:

- First, the total company expenses at function code detail (Tab 5, pages 1-23, Column E) were multiplied by the Part 64 regulated factors (Column F), resulting in regulated expenses by function code (Column G). I then subtracted any amounts associated with Shared Network Facility Arrangements ("SNFA") and Other Adjustments (Column H), as these terms are defined in ARMIS, resulting in "subject to separation" expenses by function code (Column I). These "subject to separations" expenses were multiplied by the intrastate separations factors (Column J), resulting in the identification of intrastate expenses by function code (Column K). *See* Tab 5 Pages 1 to 23.
- Second, intrastate expenses by function code were adjusted to remove the expenses associated with E911 and Disabilities Access. These expenses are removed because the rates and charges that, by statute, support these services are not subject to the resale discount. *See* Tab 6 Pages 1 to 17 Column F1.
- Third, intrastate expenses by function code were adjusted to remove the expenses associated with Call Completion/Number Services and Operators Systems for use in development of the avoided cost discount when the reseller opts to not use Verizon's operators. These expenses are removed since they are not associated with services that are being resold, if the reseller is using its own operator services platform. *See* Tab 6 Pages 1 to 17 Column F2.

- Fourth, each function code associated with services available for resale was examined to determine whether it would be avoided if a subscriber were to receive service from a reseller. The results of that review are summarized in Tab 4 and detailed in Tab 6, pages 1-17, Columns H through O.
- Fifth, expenses and revenues associated with Operator Services were examined to determine the avoided costs associated with non-revenue producing operator calls when the reseller is providing their own operator services platform. *See* Tab 11.
- Sixth, the indirect functions (*i.e.*, certain function codes within the corporate operations and general support accounts) that vary proportionately to the avoidance of expenses in the direct functions were identified.
- Once the avoided costs have been determined, the development of the resale discount rate is calculated by dividing total avoided direct costs and total avoided indirect costs by the revenue of retail telecommunications services available for resale. *See* Tabs 2 and 3.

Q. Why did you use function code detail as the starting point of the study?

A. I used the function code detail as the study's starting point because at this level the Company can accurately identify and analyze the cost of the individual activities performed throughout the corporation and determine whether or not they are avoided. The Part 32 main account level used in the FCC's methodology is at too gross a level to make this determination. For example, although an account like Customer Operations contains related Service Center activities, when looking at the individual function codes, the study shows that those activities associated with Carrier service centers are not avoided, while those associated with residence and business service centers are avoided.

Q. Why is it appropriate to use separated costs for determining the resale discount?

A. The Company's expenses are allocated between the state and interstate jurisdiction through the separations process. State expenses are recovered via state charges, consisting generally of retail charges and wholesale charges. Interstate expenses are recovered through interstate charges, which generally consist of Switched Access charges, Special Access charges and End User Common Line charges (EUCL). The state resale discount should be calculated using the expenses that are recovered in the state rates. Moreover, the calculated state resale discount will not apply to those services that are purchased pursuant to interstate tariffs.

Q. In which accounts does Verizon avoid direct expenses?

A. Verizon avoids expenses in accounts associated with selling, providing, managing and maintaining the customers' services. Verizon avoids some of the expenses in the following direct accounts: Account 6611 - Product Management, Account 6612 - Sales, Account 6623 - Customer Services, and Account 6533 - Testing. Verizon also avoids some of Account 5301 - Uncollectibles.

Q. How did you determine the percentage of these accounts that are avoided?

A. As previously stated, each account was examined at the function code level. If the function involved varies directly with the volume of service, the function is treated as completely avoided. This method mathematically produces the correct result without having to depend on a forecast of lines that will migrate to resellers or to depend on a determination of the average cost per line of that function.

For example, suppose a retail florist sent a thank-you note to every purchaser of a bouquet, incurring costs of 50 cents per bouquet purchased (*i.e.*, postage, stationery, etc.) If that florist sold 10,000 bouquets last year, then he incurred \$5,000 for the "thank-you function". Suppose further that the average cost of a bouquet is \$20, so that the total revenue received for bouquets was \$200,000. Now, if the florist decides to sell bouquets wholesale (in which case he will not incur the "thank-you function" to the purchaser), he will avoid some costs. In determining what percentage of revenue he will avoid, there are three equivalent calculations that can be made:

1) On each bouquet sold, he will avoid 50 cents for the thank-you. Thus, 50 cents divided by \$20 yields 2½%. This method can be used if you know the cost per item for the avoided function as well as the average revenue associated with the item.

2) Suppose the florist were to assume that he would sell 10% of the bouquets on a wholesale basis. He could then assume that 10% of his revenue and 10% of his costs would be avoided. Then, \$500 divided by \$20,000 will still yield 2½%. This method may be useful if you don't necessarily know the cost per item for the avoided function or the average cost of the item. However, it does require a forecast of the number of units to be sold on a wholesale basis as well as knowledge of the revenue and expenses on a total basis.

3) The florist could just look at the function in total. Then, \$5,000 divided by \$200,000 still yields the correct percentage of 2½%. However, no forecast is required, although knowledge of the revenues and expenses on a total basis is still needed.

In determining the appropriate retail avoided cost discount percentage, I have employed method number 3. Although method number 2 identifies the costs that will actually be avoided by selling items through a reseller, method number 3 is computationally simpler and yields the equivalent result without the need to rely on forecasts.

Q. How did you determine the avoided administrative support costs associated with avoided functions?

A. The costs associated with administrative support functions that the Company avoids were determined on the basis of the percentage avoidance of the functions being supported.

Q. What expenses are avoided in Account 6611 - Product Management?

A. Examining the function code detail in this account indicates that a large portion of the account contains costs associated with the development of Verizon MA's products and services that must take place in a wholesale as well as a retail environment. For example, functions such as rate and tariff development and identifying product requirements through a product's lifecycle are functions that are required to create and maintain a viable product that will be successful in either retail or wholesale markets. If these functions are not performed, Verizon MA will not have viable products to sell, whether by Verizon, or by a reseller. These costs are, therefore, not avoided. By contrast, the study identifies those portions of the costs in this account that are avoided. They include work associated with developing and implementing retail marketing programs, analysis of the external marketplace and related supervision and support costs. The function codes provide the level of detail necessary to determine the amount of this account that Verizon MA avoids.

Q. What expenses are avoided in Account 6612 - Sales?

A. The Sales account reflects costs incurred in performing functions related to selling products and services directly to retail customers, such as the determination of individual customer needs, development of customer-specific proposals, processing of sales orders, and preparation of sales records. Verizon MA treats all of the functions in this account as avoided because none of these functions are needed for retail customers that migrate to a reseller.

Q. What expenses are avoided in Account 6623 - Customer Services?

A. The avoided costs in Account 6623 consist of portions of Customer Accounting and Service Center Functions.

Q. Let's first consider Customer Accounting. What type of expenses are in Customer Accounting?

A. Customer Accounting expenses are those incurred to issue and mail customer's bills as well as to receive and process payments. The primary activities associated with Customer Accounting are the creation and maintenance of customer account files, the processing and rating of toll and local messages, the monthly processing of customer accounts, the printing and mailing of customer bills, and the handling of remittances associated with those customer bills.

Q. What Customer Accounting functions are avoided?

A. With resale, the expenses associated with bill postage and billing and collection functions for end users are avoided. Verizon MA will not render a bill to the end user, but instead will provide bulk billing to the reseller.

Q. Please describe more fully the functions associated with the activities that are avoided under resale.

A. The specific functions associated with the Customer Accounting account that I have identified as avoided are as follows:

Remittance Processing - This function includes the receipt of mail payments from customers, public offices, and agencies within a centralized operation. In addition, this function is responsible for opening and processing the Centralized Mail Remittance payments and listing payment records. The reseller will be responsible for collecting the end user's payment.

Accounts Processing - This function is responsible for processing mechanized and manual billing adjustments. In addition, this function applies payments and credits as well as calculates the balance due. The reseller will perform this functionality for the end user.

Customer Billing - This function separates, encloses and mails customer billing outputs, treatment notices, and produces automated collection letters. In addition, the expenses captured in this function code include the cost of postage, the mailing of customer bills, and customer bill stationary. Since the reseller will bill the end user directly, Verizon avoids these costs. Administrative support functions for the above activities are also avoided.

Q. What Customer Accounting functions are not avoided?

A. Customer Accounting functions such as recording, rating, and service and equipment processing will still be required for the provisioning and billing of resale services. The Company must continue to record and rate the local and toll messages, apply the appropriate resale discount, and forward this information to the reseller. The rating must be done for the billing of the resellers and to be able to respond to reseller billing inquiries. Since the Company continues to maintain the resold access line and associated features, this customer-specific service and equipment information must be stored and requires continual updating. These activities and associated costs are not avoided in a resale environment.

Q. Please describe more fully the functions associated with the activities that are not avoided under resale.

A. The specific functions associated with the Customer Accounting account that have been identified as not avoided are as follows:

Carrier Access Billing - This function performs accounting for toll, service order, remittance and customer billing operations associated with the billing of carrier access revenues. Since access services are not subject to resale, this expense is not avoided.

Toll Message Operations - This function is responsible for receiving and transmitting message records, as well as detecting and distributing errors to the appropriate correction group. This activity continues to be required for resale services.

Service Order/Accounts Master File Operations - This function is responsible for maintaining the database that associates an end user's customer record information with the network facilities assigned to that customer. This function continues to be required with resale.

Q. Have you been able to identify the actual percentage of the expenses in the Customer Accounting Account that are avoided?

A. No. Along with the expenses Verizon MA incurs for its own end user billing, most of the expenses associated with the Billing and Collection service we provide to the carriers on a contractual basis are also included in these functions. The Billing and Collection service sold to the carriers is not a telecommunications service subject to resale, and therefore, the expenses associated with it are not avoided. However, the function codes are the same, whether for the Carrier Billing service or Verizon's own, so these expenses cannot be discretely identify and removed. Nor can Verizon MA, absent a special study which I have not done, identify the expenses associated with Toll Message Operations and Service Order/Accounts MasterFile Operations. I have not adjusted the Customer Accounting expenses for these activities which effectively avoids 100% of these function codes. This conservative approach results in an over avoidance of Customer Accounting expenses and thereby artificially increases the resale discount.

Q. Let's now consider Service Center Functions. What types of expenses are in Service Center Functions?

A. The Service Center Functions expenses are those associated with preparing, changing, and handling customer related service orders. In addition, they include expenses associated with collecting revenues and handing miscellaneous customer relations such as billing and account inquiry, customer instruction, annoyance call complaints, and updating customer records.

Q. What Service Center Functions are avoided?

A. The functions associated with the Residence and Business Service Center Functions that have been identified as avoided with resale are as follows:

Residence and Business Service Center - This function is responsible for creating and transmitting residence and business service orders to the field forces and receiving completed service orders from the field forces. The reseller will perform this function for their customers.

Account/Billing Inquiry - This function is responsible for handling residence and business customer billing inquiries and collecting overdue and final accounts, as well as maintaining customer records. The reseller will respond to their customers' inquiries.

Demand Sales - This function is responsible for handling residence and small business related matters with customers, discussing and selling services and maintaining customers' records. The reseller will negotiate with and sell to their customers.

Customer Payment Operations - This function is responsible for receiving, depositing, reporting customer payments with the service center and collecting from unpaid accounts. The reseller assumes this responsibility for the collection of the end user's bill.

Centralized Operations Group - This function is responsible for negotiating with the customer's equipment vendors. These negotiations include discussing service offerings, negotiating service orders, and discussing credit terms with customers. In a resale environment, the reseller will assume responsibility for these vendor negotiations.

Customer Instruction - This function is responsible for training and instructing customers in how to use their telecommunications services. The reseller will be responsible for providing customer instruction. Administrative support functions for each of the above activities are also avoided.

Q. What Service Center Functions are not avoided?

A. The specific activities associated with Service Center Functions that Verizon MA avoids are:

Annoyance Call Bureau - This function is responsible for handling inquiries or complaints concerning abusive, threatening, or obscene calls. This work will be performed by Verizon for the reseller.

Premises Management Information System (PREMIS)/Street Address Guide Bureau - This function maintains and updates Mechanized Street Address Guide File, as well as provides living unit information. Resellers will use this utility in their service order negotiation process.

ICSC - This function is responsible for processing and completing Carrier Access service orders. Since access services are not subject to resale, this expense is not avoided.

Message Investigation - This function is responsible for investigating questions concerning toll messages, including toll fraud, as well as to secure toll billing data. This function will be performed for both Verizon and the reseller.

Q. What expenses are avoided in Testing?

A. The testing expenses that are avoided are those expenses associated with Testing Subscriber Reports. This includes the subscriber line testing associated with receiving, recording and analyzing customer trouble reports. With resale, an end-user customer's call to report a trouble, currently made to the Verizon MA Repair Service, will now go directly to the reseller. In addition, the initial trouble testing that is currently handled by

Verizon MA's Centralized Repair Service Attendant Bureau (CRSAB) and Customer Services Bureau (CSB) will be performed by the reseller. Therefore, the Testing Subscriber Reports and related support expenses in account 6533 are avoided.

Q. What testing expenses are not avoided?

A. The specific functions associated with the Testing account that Verizon MA does not avoid are as follows:

Subscriber Line Testing - Maintenance - This includes the testing of rearrangements and changes of network facilities, testing requested by field personnel and acceptance testing for construction of new facilities. These expenses are not avoided because Verizon MA will perform this type of testing for the reseller.

Interoffice Testing - This includes the testing of facilities between different central offices. These expenses are not avoided because Verizon MA will perform this type of testing for the reseller.

Q. How did you treat Uncollectibles?

A. Although not booked as an expense according to FCC Part 32 rules, uncollectibles are a real cost of providing service - a cost that will vary with the level of retail customer output. However, it has nothing to do with the level of expenses, avoided or not. It is a function of revenue and a customer's ability to pay - whether that customer is an end user or a reseller. With resale, uncollectibles should decrease since we will be collecting from a few resellers instead of millions of end users. Therefore, in calculating the avoided cost discount percentage, we reflect a majority of uncollectibles as being avoided. This avoided percentage is based on the level of Access Services uncollectibles Verizon MA is currently realizing with Interexchange Carriers. Although it is unlikely that all resellers will be as reliable and credit worthy as today's IXC's, this is Verizon MA's only experience on which to base an avoided determination. This conservative approach serves to overstate the avoided costs and therefore inflate the resale discount.

Q. What Operator Services expenses are avoided when the reseller provides its own Operator Services?

A. The Call Completion, Directory Assistance and Operator Systems expenses that are avoided are only those expenses that exceed the revenues specific to these services, referred to as the Operator Services shortfall. These shortfall expenses are related to non-revenue producing calls (e.g. dialing instructions, rate information, etc.) that are avoided if Verizon MA is not providing the Directory Assistance and Call Completion functions. In that instance, these calls will be directed to the resellers' operators.

Q. How did you calculate the Operator Services shortfall?

A. The study calculated the Operator Services shortfall by subtracting Operator Services revenue, excluding the Directory Assistance portion for recovery of E911, from total Operator Services expenses in account 6621, account 6622 and account 6220.

Q. In which accounts will Verizon avoid indirect expenses?

A. The indirect expenses that are avoided include costs associated with some of the functions reflected in Accounts 6121 to 6124 - General Support expenses and Accounts 6711 to 6728 - Corporate Operations expense.

Q. How were these avoided indirect expenses determined?

A. The indirect avoided expenses were determined as follows:

- Each function code in the indirect expense accounts was analyzed to determine if it directly supports an avoided direct function.
- These indirect expenses were classified as either fixed or variable relative to the level of retail output. If the expenses are fixed, they are not avoided. An example of this type of fixed expense is the expense of information system programming and maintenance (Account 6724 - Information Management). This function does not vary based on the level or the existence of retail output, and therefore, is not avoided.
- For those expenses that are variable, each function code would be analyzed to determine the portion that would be avoided. The amounts that are avoided are based on the functions being supported. For example, if a General Purpose Computer maintenance function supports Sales, it would be avoided in the same proportion as Sales; if it supports Product Management, it would be avoided in the same proportion as Product Management.
- Finally, the general and administrative expenses (Account 6728) that vary directly with the number of employees (*e.g.*, sickness and disability payments) are avoided based on the ratio of avoided direct expense to total company direct expenses. This avoided direct expense to total company direct expense ratio would need to be calculated twice - once for the discount assuming Verizon MA operators are used and no Operator Services expenses are avoided, and again for the discount assuming reseller operators are used and the Operator Services shortfall expenses are avoided.

Q. Turning now to the denominator in the calculations, what are the appropriate revenues to exclude in the calculation of the resale discount rates?

A. **1. Access revenues** - These services are not subject to the resale discount since they are not generally available to the public as stated in the definition of telecommunications services used in the Act. "The term 'telecommunications service' means the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used."

The FCC order in paragraph 980 states that the IXC must "purchase access services from incumbent LECs outside of the resale framework of 251(c)(4), through the existing interstate access tariffs."

2. End User Common Line ("EUCL") revenues - The EUCL is not subject to the resale discount rate. The FCC order in paragraph 984 provides that "although incumbent LECs may continue to recover the [EUCL] when other carriers resell their local exchange services, the [EUCL] is not subject to the wholesale pricing standard of section 252(d)(3)."

3. Nonregulated services revenues - These revenues, as identified in FCC Part 64 Separation of Regulated and Nonregulated Costs, are associated with services that are not tariffed telecommunications services (*e.g.* the installation or repair of customer premise inside wiring).

4. Billing and Collection service revenues - This service is not a telecommunications service.

5. Miscellaneous Operating Revenues - These revenues are removed since they are not associated with telecommunications services. They are revenues associated with Rents, Corporate Operations Activities, and Other Incidental Regulated Charges.

6. Other revenues - Revenues associated with Cellular Mobile and other Mobile revenues have been removed.

7. All Interstate revenues - These have been removed since the Resale Discount to be determined by the state commissions will apply only to Intrastate services.

Q. Besides the overall categories mentioned above, what further adjustments were made to the revenues in the calculation of the resale discount rate?

A. The study includes the revenues associated with those intrastate services that are subject to resale. Revenues were then adjusted for the following:

- Revenues exclude the regulated E911 revenues.
- Revenues exclude all Operator Services revenues in the scenario assuming the reseller uses their own operators.

Q. In summary, what are the resale discount rates that are appropriate for Verizon Massachusetts, Inc.?

A. As mentioned earlier, I have developed two discounts - a discount for resellers who resell Verizon's Operator Services, and a discount for resellers who provide their own Operator Services. The discounts are displayed in Tab 1 of the attached study, and they are summarized below:

Reseller using own Operator Using Verizon MA Operator

14.38 % 16.26 %

Q. Does that conclude your testimony?

A. Yes, it does.

VERIZON MASSACHUSETTS

D.T.E. 01-20

DIRECT TESTIMONY

OF

LOUIS D. MINION

FEBRUARY 12, 2001